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STATE FOR EAP/CM AND EEB/OMA, TREASURY FOR OASIA

E.O. 12958: N/A
TAGS: ECON EFIN EINV ETRD HK CH
SUBJECT: Lehman Report Disappoints, HK Outlook Dreary

¶1. Summary: The Hong Kong Monetary Authority (HKMA) and Securities and Futures Commission (SFC) each issued reports on their investigations of Lehman Bros. minibond complaints. Most complainants have been asked to provide additional information; just 238 cases have been referred for additional investigation so far. The government is considering new legislation to protect investors. The HKMA has added over USD 20 billion to the Hong Kong money supply since September 2008; although interest rates have dropped, lending activity has yet to pick up. The Hang Seng Index was virtually unchanged from December 31, 2008, closing January 9 at 14,377 on volume of HKD 45 billion. End Summary.

Lehman Report Disappoints Investors

¶2. On January 8, the HKMA and the SFC delivered their investigation reports on the Lehman Bros. minibond investigation to Financial Secretary John Tsang. Minibond investors said they were disappointed as parts of the two reports relating specifically to on-going investigations of retail bank mis-selling of Lehman products were excised. Tsang promised that the "temporarily confidential contents" would be made public when investigations are complete.

¶3. The HKMA, which received nearly 20,000 complaints from purchasers of Lehman products, made 19 recommendations for improving coordination with the SFC and improving education but insisted that the current disclosure-based regulatory system for new investment products should remain in place. The SFC recommendations were more aggressive, favoring changes in Hong Kong's regulatory structure, educational activities and enforcement powers. The SFC also recommended referring to the United Kingdom Financial Services Authority's Treating Customers Fairly (TFC) principles. In an interview on January 9, HKMA Chief Executive Joseph Yam denied that the Lehman Bros. minibond problem was related to local regulations and warned of "blindly" copying foreign regulatory systems.

¶4. KC Chan, Secretary for Financial Services and the Treasury, has been tasked with conducting a review of the two reports and drafting a consultation paper based on the recommendations made by the HKMA and SFC to balance necessary regulation and financial innovation.

Bears Abound in Hong Kong

¶5. On January 6, HKMA's Yam told the Hong Kong Chinese General Chamber of Commerce that he is pessimistic about the chances of Hong Kong's economy recovering in 2009. Yam predicted that the first six to nine months of 2009 would be difficult as the economy is certain to contract. He announced that HKMA has purchased USD 20.8 billion worth of foreign currency since September 2008, raising the aggregate balance of the Hong Kong interbank market to over HKD 175 billion. Although the flooding of Hong Kong dollars into the interbank market has pushed HIBOR rates down, local bankers remain very cautious and lending has not picked up. As of Friday, January 09, HIBOR overnight, 1-week and 2-week rates all stood at 0.1 percent; the three month rate dropped to 0.85 percent.

¶6. Hong Kong University economist Dr. Alan Siu released a report January 7, predicting Hong Kong's economy would contract throughout
¶2009. Hong Kong General Chamber of Commerce economist David O'Rear agreed that zero growth in Hong Kong would be a very good year. HSBC Economic Advisor George Leung is even more pessimistic. Leung told the pro-Beijing Wen Wei Po (Dec. 30) that global credit markets would need five years to recover fully. He predicted the U.S. and Hong Kong wouldn't see the bottom for another three years. Credit Suisse Chief Economist Tao Dong told Hong Kong Commercial Daily (Jan. 7) that the recovery process of the Hong Kong economy in the next 12 months would mainly depend on banks willingness to resume lending.

Hang Seng Falls 50 percent in 2008

¶7. The Hang Seng Index closed at 14, 377.44 on Friday, January 09, down 38.47 points or 0.27 percent from Thursday's close. Daily volume was HKD 45 billion. The Hang Seng Index closed at 14,387.48 on December 31, the last trading day of 2008 with a record low transaction volume of HKD 19.5 billion (in half-day trading). The Hang Seng Index lost 48.3 percent in 2008; it had closed at 27,812.65 at the end of 2007. Analysts estimated that the total fall in market capitalization in 2008 was over HKD 10 trillion (about USD 1.3 trillion).